DEPARTMENT OF STATE REVENUE

18-20120283.LOF

Letter of Findings: 18-20120283
Financial Institutions Tax
For the Years 2005-2007

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ISSUES

I. Financial Institutions Tax – Inclusion of Corporation.

Authority: IC § 6-5.5-1-17; IC § 6-5.5-1-18; IC § 6-5.5-2-1; IC § 6-5.5-2-8; IC § 6-5.5-3-1; IC § 6-5.5-4-12; IC § 6-8.1-5-1; 45 IAC 17-2-1; P.L. 68-1991; Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Letter of Findings 18-20100720 (January 24, 2012); Letter of Findings 18-20110569 (January 24, 2012).

Taxpayer protests the exclusion of one corporation from its combined group for FIT purposes.

II. Financial Institutions Tax – Correction of Inter-Company Elimination.

Authority: IC § 6-8.1-5-1.

Taxpayer protests what it claims to be an error in eliminating certain intercompany receipts.

III. Financial Institutions Tax – Mathematical Error.

Authority: IC § 6-8.1-5-1.

Taxpayer protests what it claims to be a mathematical error in its audit.

IV. Financial Institutions Tax – Credits.

Authority: IC § 6-8.1-5-1.

Taxpayer protests what it claims to be an error in computing credits against its tax liabilities.

V. Financial Institutions Tax – Net Operating Loss.

Authority: IC § 6-5.5-2-1.

Taxpayer protests what it claims to be an error in attributing net operating losses within its affiliated group.

STATEMENT OF FACTS

Taxpayer is a corporation domiciled outside Indiana. Taxpayer filed combined Financial Institutions Tax (FIT) returns for the 2005, 2006, and 2007 on behalf of several affiliated corporations.

For 2005 and 2006, Taxpayer was not included as part of the unitary group in the returns as filed, even though Taxpayer was listed on the returns as the filing corporation. For 2007, Taxpayer was included as part of the combined group in the returns as filed.

The Indiana Department of Revenue ("Department") conducted an audit of Taxpayer which concluded that various subsidiaries included in Taxpayer's returns should have been excluded, along with various other adjustments. For 2007, the Department removed Taxpayer from the combined return. For 2005 and 2006, the Department did not include Taxpayer in the unitary group.

Taxpayer protested the assessment. A hearing was held and this Letter of Findings results. Additional facts will be presented as necessary.

I. Financial Institutions Tax – Inclusion of Corporation.

DISCUSSION

Taxpayer protests the Department's determination that Taxpayer was not conducting the business of a financial institution in Indiana. Taxpayer raises two separate issues. First, Taxpayer asserts that its own activities in Indiana are sufficient to permit inclusion for FIT purposes. In the alternative, Taxpayer asserts that its ownership of an interest in a limited partnership that conducts business in Indiana is sufficient to permit its inclusion.

The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

The FIT is imposed on taxpayers transacting the business of a financial institution within this state. IC § 6-5.5-2-1. 45 IAC 17-2-1 elaborates that the FIT "is intended to tax both traditional financial institutions that are transacting business within Indiana, as well as other types of businesses that are deemed to be transacting the business of a financial institution in Indiana."

A. Taxpayer's Own Activities

Taxpayer asserts that its own activities, standing alone, require its inclusion in Taxpayer's combined return. The issue is whether Taxpayer's own activities are sufficient to permit inclusion in a combined return for FIT purposes.

IC § 6-5.5-1-18(a) states:

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon, or

contributory to one another, individually or as a group, in transacting the business of a financial institution. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a corporation, a partnership, a limited liability company, or a trust, provided that each member is either a holding company, a regulated financial corporation, a subsidiary of either, a corporation that conducts the business of a financial institution under IC 6-5.5-1-17(d)(2), or any other entity, regardless of its form, that conducts activities that would constitute the business of a financial institution under IC 6-5.5-1-17(d)(2) if the activities were conducted by a corporation. The term "unitary group" includes those entities that are engaged in a unitary business transacted wholly or partially within Indiana. **However, the term does not include an entity that does not transact business in Indiana. (Emphasis added).**

IC § 6-5.5-3-1 states:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

(1) maintains an office in Indiana;

(2) has an employee, representative, or independent contractor conducting business in Indiana;

(3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;

(4) regularly solicits business from potential customers in Indiana;

(5) regularly performs services outside Indiana that are consumed within Indiana;

(6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;

(7) owns or leases tangible personal or real property located in Indiana; or

(8) regularly solicits and receives deposits from customers in Indiana.

Taxpayer asserts that it engaged in various activities which constituted "transacting business within Indiana." First, Taxpayer asserts that it owned subsidiaries that conducted business in Indiana.

Second, Taxpayer argues that it held municipal loans from Indiana each year. Taxpayer's protest states that Taxpayer received between $34,000 and $69,000 in Indiana municipal bond interest for each year.

Third, Taxpayer assets that it "maintained strong centralized management" over its subsidiaries, including substantial planning and support activities on behalf of its subsidiaries, receipt of dividends, and use of Taxpayer's trademarks by its subsidiaries.

Fourth, Taxpayer states that it had intercompany loans to a subsidiary otherwise included in the combined FIT return. Taxpayer lists the loans as having balances of between $740,000,000 and $1,250,000,000 for each year.

Fifth, Taxpayer argues that it had net intercompany reimbursed expenses. These expenses totaled between $68,000,000 and $88,000,000 for each year.

Sixth, Taxpayer asserts that it had common officers with its subsidiaries. In particular, Taxpayer notes that the directors of two Indiana subsidiaries were also directors of Taxpayer and that these directors "performed services the benefit of which was in Indiana and conducted business of [Taxpayer] in Indiana."

Seventh, Taxpayer states that it owned real estate in Indiana through a limited partnership which held an interest in another limited partnership.

In this case, Taxpayer has receipts from Indiana, both from municipal bond interest, as provided under IC § 6-5.5-4-12, and receipts from its interest in an Indiana limited partnership.

That stated, Taxpayer has established that it is a financial institution within the meaning of IC § 6-5.5-1-17. The next question is whether Taxpayer has established that it is "transacting business within Indiana" as defined under IC § 6-5.5-3-1.

Taxpayer's claimed Indiana employees are directors in both Taxpayer and Taxpayer's subsidiaries. In this case, it cannot be stated that the roles of directors of two related corporations–one of which does business in Indiana–is sufficient to permit Taxpayer to claim that it has "an employee...conducting business in Indiana" within the meaning of IC § 6-5.5-3-1(2).

Even though Taxpayer performs services on behalf of its subsidiaries, the services performed appear to not be on behalf of consumers but rather consists of the management of a group of commonly-owned banks. Further, even though Taxpayer engages in intercompany loans with its various subsidiaries, the subsidiaries themselves are not "customers" as provided under IC § 6-5.5-3-1(6).

Furthermore, even acknowledging that Taxpayer owns an interest in a limited partnership which (through a second limited partnership) owns Indiana real estate, Taxpayer itself does not own or lease that Indiana real property and cannot avail itself of pass through treatment of the partnership to state that Taxpayer owns Indiana real property.

Taxpayer also notes that its activities are activities which are permitted under state and federal laws governing bank holding companies and regulated financial institutions. The Department acknowledges that Taxpayer's activities are permitted by law for bank holding companies. However, IC § 6-5.5-3-1 provides a different definition for FIT purposes of what constitutes "transacting business within Indiana." Thus, it is entirely

possible for a bank holding company to conduct permitted business operations in Indiana and yet not meet the tax definition of "transacting business within Indiana."

Taxpayer also asserts that its presence in Indiana is at most minimal compared to its overall operations. The Department acknowledges that Taxpayer has not arranged its business operations in such a manner to intentionally avoid or evade Indiana FIT. However, this standing alone does not require of Taxpayer in a combined FIT with various subsidiaries of Taxpayer.

In summary, Taxpayer has not provided sufficient information to conclude that it is transacting the business of a financial institution in Indiana within the meaning of IC § 6-5.5-3-1. Thus, Taxpayer's protest is denied to the extent that Taxpayer itself is claiming any Indiana activity as a financial institution.

B. Indiana Partnership Interest

In the alternative, Taxpayer asserts that it owns an interest in a limited partnership ("LP"). LP owns an interest in a second limited partnership ("LP2"). LP2 leases and operates a shopping mall in Indiana.

IC § 6-5.5-2-8, which states:

If a corporation is:

(1) transacting the business of a financial institution (as defined in IC 6-5.5-1-17(d); and

(2) is a partner in a partnership or the grantor and beneficiary of a trust transacting business in Indiana and **the partnership or trust is conducting in Indiana an activity or activities that would constitute the business of a financial institution if transacted by a corporation**;

the corporation is a taxpayer under this article and shall, in calculating the corporation's tax liability include in the corporation's adjusted or apportioned income the corporation's percentage of the partnership or trust adjusted gross income or apportioned income. (Emphasis added).

IC § 6-5.5-1-17(d) provides:

(d) For purposes of this section and when used in this article, "business of a financial institution" means the following:

(1) For a holding company, a regulated financial corporation, or a subsidiary of either, the activities that each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such a subsidiary under Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)), as in effect on December 31, 1990.

(2) For any other corporation described in subsection (a)(4), all of the corporation's business activities if eighty percent (80 [percent]) or more of the corporation's gross income, excluding extraordinary income, is derived from one (1) or more of the following activities:

(A) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include:

(i) secured or unsecured consumer loans;
(ii) installment obligations;
(iii) mortgage or other secured loans on real estate or tangible personal property;
(iv) credit card loans;
(v) secured and unsecured commercial loans of any type;
(vi) letters of credit and acceptance of drafts;
(vii) loans arising in factoring; and
(viii) any other transactions with a comparable economic effect.

(B) Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes.

(C) Operating a credit card, debit card, charge card, or similar business.

As used in this subdivision, "gross income" includes income from interest, fees, penalties, a market discount or other type of discount, rental income, the gain on a sale of intangible or other property evidencing a loan or extension of credit, and dividends or other income received as a means of furthering the activities set out in this subdivision.

The "business of a financial institution" is defined by meeting either one of two tests. The first test is whether a company is a "holding company, a regulated financial corporation, or a subsidiary of either" and engaged in activities authorized under state or federal law. Once this test is met, the company is automatically considered to be a financial institution, regardless of the actual sources of the company's income.

The second test is an income-based test. To meet this test, a company must derive eighty or more percent of its gross income from certain specified sources.

Taxpayer is a federally regulated bank holding company and thus is "transacting the business of a financial institution" as required for IC § 6-5.5-2-8(1). The issue is whether LP and/or LP2 have "an activity or activities that would constitute the business of a financial institution if transacted by a corporation."

In this particular case, LP and LP2 are not organizations described in IC § 6-5.5-1-17(d)(1). LP2 leases space at a shopping mall and operates a shopping mall. LP2's activities are not considered leases "that [are] the economic equivalent of the extension of credit" or any other activity described in IC § 6-5.5-1-17(d)(2). LP's

activities consist solely of owning LP2, and likewise do not meet the requirements of IC § 6-5.5-1-17(d)(2). Thus, LP and LP2 do not meet the requirements of "transacting the business of a financial institution" required for inclusion of the partnership under IC § 6-5.5-2-8(2), even though Taxpayer's ownership of LP and LP2 is permitted under Indiana and federal law. However, Taxpayer's interest in LP is sufficient to permit taxation under IC § 6-3 (adjusted gross income tax).

Taxpayer cited to two Letters of Finding, Letter of Findings 18-20100720 (January 24, 2012) and Letter of Findings 18-20110569 (January 24, 2012), both found at 20120328 Ind. Reg. 045120120NRA, which Taxpayer stated stands for the proposition that its interest in LP and/or LP2 is sufficient to permit inclusion for financial institutions tax purposes. However, in the Letters of Finding cited by Taxpayer, the partnership in question was itself engaged in the business of a financial institution as defined by IC § 6-5.5-1-17. In this case, LP and LP2 are not engaged in the business of a financial institution, and thus the Letters of Findings cannot be used to permit Taxpayer's inclusion based solely on its ownership of LP and LP2.

FINDING

Taxpayer's protest is respectfully denied.

II. Financial Institutions Tax – Correction of Inter-Company Elimination.

DISCUSSION

Taxpayer protests the amount eliminated as a result of the removal of one subsidiary. Taxpayer acknowledges that the subsidiary should not have been included in Taxpayer's combined return. Based on the elimination of the subsidiary, the Department's audit report removed the subsidiary's receipts from Taxpayer's combined group's receipt denominator. However, Taxpayer asserts that a substantial portion of those were intercompany receipts and therefore already eliminated. The issue is whether Taxpayer has met its burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made, as required under IC § 6-8.1-5-1(c).

Based on the information presented by Taxpayer at hearing, the Department is unable to accept Taxpayer's assertions. However, Taxpayer has provided sufficient information to conclude that a portion of the subsidiary's receipts may have previously been eliminated and thus an appropriate adjustment may be required. Thus, the Department will review Taxpayer's assertions and make any appropriate adjustments in a supplemental audit.

FINDING

Taxpayer's protest is sustained subject to a supplemental audit review.

III. Financial Institutions Tax – Mathematical Error.

DISCUSSION

Taxpayer protests a claimed mathematical error in computing its receipts denominator. In particular, for 2005, Taxpayer asserts that it reported one amount for receipts ("Per Return Receipts"), while the audit removed a portion of those receipts ("Adjustments"). The difference is "Per Audit Receipts," which was to be used as the receipts denominator for apportionment purposes. However, according to Taxpayer, the amount listed as Per Audit Receipts was not equal to this difference. Instead, according to Taxpayer, the Per Audit Receipts listed in the audit report was equal to the Per Return Receipts minus Adjustments minus an additional amount of roughly $34,600,000. The issue is whether Taxpayer has met its burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made, as required under IC § 6-8.1-5-1(c)

In reviewing the audit report, Taxpayer is correct that there is a mathematical error in the audit report. However, the individually-listed numbers in the Per Audit Receipts column add up to the listed total. The individually-listed numbers in the Per Return Receipts do not add up to Taxpayer's self-reported total receipts.

Nevertheless, the audit does list two separate numbers for the appropriate adjustment to be made to the denominator. Taxpayer has not provided sufficient information to conclude that the auditor erred. Nevertheless, Taxpayer has provided sufficient information to conclude that another review of the appropriate adjustment to the receipts denominator is justified. Thus, the Department will review Taxpayer's assertions and make any appropriate adjustments in a supplemental audit.

FINDING

Taxpayer's protest is sustained subject to a supplemental audit review.

IV. Financial Institutions Tax – Credits.

DISCUSSION

Taxpayer protests a claimed error in computing its total credits. In particular, Taxpayer noted a discrepancy between its reported credits and the credits listed by the Department. The issue is whether Taxpayer has met its burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made, as required under IC § 6-8.1-5-1(c).

After the hearing, the Department provided a copy of its credit computations to Taxpayer for review. After review, Taxpayer indicated that it was willing to accept the Department's computation. Thus, Taxpayer's protest is denied on this issue.

FINDING

Taxpayer's protest is respectfully denied.

V. Financial Institutions Tax – Net Operating Losses.

DISCUSSION

Taxpayer protests a claimed error in allocating its net operating losses available for carryforward.

Under IC § 6-5.5-2-1(d), a net operating loss is prorated between members of a unitary group based on the ratio of the member's Indiana receipts to overall Indiana receipts. For example, assume that a unitary group consisted of Member A and Member B. The unitary group has a net operating loss of $20. Member A has $150 in Indiana receipts, while Member B has $50 in Indiana receipts. Member A is attributed as having seventy-five percent of the net operating loss ($150 of receipts for Member A divided by $200 overall receipts), or $15. Member B is attributed as having twenty-five percent of the net operating loss ($50 of receipts for Member B divided by $200 overall receipts), or $5. For years after the current year, Member A and Member B's shares of the group's positive income would be prorated similarly and each member's share of the net operating loss applied against their respective prorated incomes.

In this case, the Department's audit prorated $95,000,000 of Indiana loss. Based on the information contained in the Department's audit report, it is not clear how the Department derived the $95,000,000 loss. Though Taxpayer has not provided sufficient information to conclude that the $95,000,000 loss was incorrect or that an alternative amount of net operating loss was correct, Taxpayer has provided sufficient information to conclude that further review of the amount of net operating loss for 2007 is justified. The exact net operating loss available (and the proration thereof) will be determined upon supplemental audit.

Though not addressed at hearing, the Department's audit listed apparently inconsistent receipts for one affiliated corporation in 2007 for purposes of prorating net capital losses and net operating losses, even though IC § 6-5.5-2-1 requires proration of both based on the Indiana receipts for the unitary group for the year in which the loss is incurred. Thus, it appears that the Department should have used the same Indiana receipts for prorating net capital losses and net operating losses.

In addition, the receipts listed for the same affiliated corporation for all three years appear inconsistent with the receipts used for apportionment purposes prior to elimination. The Department's audit division shall look at any attribution of net capital losses and make any appropriate adjustments to the proration of the losses.

FINDING

Taxpayer's protest of the 2007 net operating loss determined by the Department is sustained subject to audit review. Taxpayer's net capital loss proration shall be redetermined upon supplemental audit.

CONCLUSION

Taxpayer's protest is denied on Issue I and Issue IV. Taxpayer's protest is sustained subject to supplemental audit review on Issues II, III, and V.

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